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SUPREME COURT OF THE UNITED STATES

October Term, 1995

JOHN L. KEMMERER and
JAMES L. JORDAN,

Petitioners,

v.

ICI AMERICAS, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

In a case involving an employer's premature termination of a deferred compensation plan enforceable under ERISA:

(a) Are damages for the loss of the benefits of tax deferral too speculative to be recoverable because they necessarily depend on unpredictable future tax rates?

(b) Are such damages too speculative to be recoverable because at some hypothetical future time the employer might not have been financially able to make the promised deferred compensation payments?

(c) By so holding, did the Court of Appeals impermissibly ignore the Congressional intent as expressed in ERISA that such deferred compensation plans be enforceable?

LIST OF ALL PARTIES

The caption contains the names of all parties.

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OPINIONS OF THE COURTS BELOW

The opinion of the United States Court of Appeals for the Third Circuit is reported at 70 F.3d 281 (3d Cir. 1995) and appears in the attached appendix at pages 1a through 17a. The opinion of the United States District Court for the Eastern District of Pennsylvania, dated December 22, 1994, is unreported and appears in the attached appendix at pages 18a through 23a.

STATEMENT OF JURISDICTION

The United States Court of Appeals for the Third Circuit filed its opinion and judgment on November 17, 1995 and denied a timely petition for rehearing and rehearing in banc on December 19, 1995. (See attached appendix at 1a-17a & 24a-25a). This petition is filed within ninety days of the denial of rehearing. Jurisdiction of this Court is based on 28 U.S.C. § 1254(1).

STATUTES

29 U.S.C. § 1001(b)

"It is hereby declared to be the policy of this chapter to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts."

29 U.S.C. § 1132(a)(1)(B)

"A civil action may be brought by a participant or beneficiary ... to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan. . . ."

STATEMENT OF THE CASE

Petitioners are retired executives of ICI Americas, Inc., who were participants in an unfunded deferred compensation plan (the "Plan") that was subject to the enforcement provisions of ERISA. Pursuant to the Plan, on his retirement in 1986 petitioner Jordan elected to receive his deferred compensation and the earnings thereon in installments over a period of 21 years, through 2007. Petitioner Kemmerer retired in 1988 and elected to receive the funds over a similarly

extended period. No taxes were payable on the deferred compensation or the "earnings" thereon until receipt.[1]

In late 1991, ICI unilaterally terminated the Plan, established a new and similar plan into which only active executives could roll over their account balances and continue to defer taxation, and paid the retired executives their accumulated account balances in three annual lump sum installments with 10% interest on the unpaid balances.

Petitioners demanded that ICI honor its agreement by adhering to the agreed-upon extended payment schedule. ICI ignored their protests and wired the lump-sum distributions into their bank accounts. An internal review procedure thereafter denied them any relief and they filed suit.[2] The district court granted petitioners' summary judgment motion on liability in January 1994, finding that ICI's premature termination of the Plan was a violation of the terms of the Plan and of ERISA. At the damage trial that followed, however, the district court concluded that petitioners had not met their burden of proving that they were damaged.

In affirming,[3] the United States Court of Appeals for the Third Circuit concluded that damages for the loss of tax deferral that occurs when a deferred compensation plan is prematurely terminated are too speculative to be recoverable

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1. There were no actual earnings because ICI had free use of the funds. Instead, petitioners designated investment portfolios available in another ICI plan, and ICI credited their deferred salaries with the same rate of return.

Hereafter this Petition will refer to only the facts pertaining to Jordan. In all relevant respects the facts pertaining to Kemmerer do not differ from those pertaining to Jordan.

2. The district court had subject matter jurisdiction over the action pursuant to 28 U.S.C. §§ 1331 & 1332(a), and 29 U.S.C. § 1132(e).

3. Petitioners do not regard as appropriate reasons for *certiorari* the Court of Appeals' affirmance of the district court's erroneous application of burden of proof principles and its failure to follow the requirements of Fed.R.Civ.Proc. 52(a). Those errors however help explain the result below and therefore are preserved, and are described in the appendix hereto at 47a through 49a. Petitioners also preserve the issue of whether the Court of Appeals erred in holding that the district court's finding that petitioners suffered no transaction costs was supported by the record. (See Appellants' Brief below, at pp. 26-28.)

because they depend on unknowable future tax rates. It concluded too, as the district court had, that a "risk premium" had to be applied in any damage calculation to account for the possibility that ICI might not have been financially able to make the agreed-upon future payments.

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT

Introduction and Summary

After petitioners completed their financial planning for their retirement years and had retired, their employer breached the terms of a deferred compensation plan by terminating it and paying out participants' funds over three years instead of sixteen as originally agreed. The Court of Appeals, in affirming a judgment in favor of the employer on damages, held that when damages are dependent on unknowable future tax rates (as damages for the premature termination of tax-deferred plans necessarily are) they are too speculative to be recoverable. This holding is directly at odds with a decision of the Court of Appeals for the Seventh Circuit, the only other reported decision that speaks to the issue.

The Court of Appeals also held that a damage award must be reduced by a "risk factor" to account for the possibility that the employer might not have been financially able to make all of the promised future payments, and that petitioners' failure to take that into account likewise rendered damages too speculative to be recoverable. This holding is so novel that neither counsel for ICI, nor the district court, nor the Court of Appeals cited any supporting authority for it. Moreover, this holding appears to be contrary to the reasoning behind this Court's decision in *Jones & Laughlin Steel Corp. v. Pfeifer,* 462 U.S. 523, 103 S.Ct. 2541 (1983). See footnote 9, *infra.*

In enacting ERISA, the Congress authorized the evolution of a federal common law that would apply to plans covered by ERISA. See *Firestone Tire & Rubber Co. v. Bruch,* 489 U.S. 101, 110, 109 S.Ct. 948, 954 (1989). The foregoing two erroneous holdings, frustrating the Congressional intent that

deferred compensation plans be *enforceable* under ERISA, represent early and serious missteps in that evolutionary process. They should be corrected now, before other employers feel free to prematurely terminate deferred compensation plans with impunity because no damages can flow therefrom, and other retirees are damaged as petitioners were.

I. Legal damages that depend for their calculation on future tax rates are not so speculative as to be unrecoverable. They can and should be determined by applying traditional burden of proof principles, as was done by the Court of Appeals for the Seventh Circuit.

What the breach of the Plan caused petitioners to lose was thirteen years of investment income on tax payments they made that otherwise would have been deferred to a much later date. That calculation requires, *inter alia,* some assumption regarding what their tax payments would have been in the future had the Plan not been breached.[4] The Court of Appeals, however, concluded that because future tax rates are by their nature unknowable, damages based on assumptions about them are so speculative as to be unascertainable. The decision is directly contrary to the conclusion reached by another Court of Appeals.

The Seventh Circuit in *Oddi v. Ayco Corp.,* 947 F.2d 257, 261-62 (7th Cir. 1992), carefully considered the issue of how to calculate damages when unknowable future tax rates are an essential component of the calculation. The plaintiff in *Oddi*

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4. For example, Petitioner Jordan's fund balance at year-end 1991, $4,674,439, was paid to him over a period of three years (1992-94) instead of sixteen years (1992-2007). Consequently the federal taxes thereon, $1,770,271, were likewise paid over three years. Had the fund balance been paid to him over 16 years, as agreed, he would have paid only $564,581 in taxes in those three years and would have earned investment income on the $1,205,690 difference. It is that investment income, net of taxes, that he lost.

Marginal tax rates were 31% when the first two payments were made and 39.6% when the third payment was made. Petitioners' damage calculations conservatively assumed that the higher rate would remain in effect thereafter, through 2007. That assumption was never challenged either by ICI or the trial court.

had chosen early retirement and had a choice of taking a lump sum distribution of his profit sharing funds or rolling them over into an IRA for continued tax-deferred savings until 2017. The defendant financial advisor, because of a computational error, convinced him that there was a three million dollar advantage in taking the lump sum distribution when in fact there was a two million dollar disadvantage. In the suit that followed, the defendant advisor argued that if tax rates were to increase sufficiently from their then historically low maximum rate of 28%, there would be no damages at all. The court held that the burden of proving that future tax rates will change is on the party making that assertion, and created a rebuttable presumption that the status quo will continue. "[T]o deny plaintiffs the benefit of a presumption", the court held, "would absolve financial advisors of any liability for their erroneous advise."[5] The same must be said here. To deny petitioners the benefit of a presumption of continuity in the tax rates would give employers *carte blanche* to prematurely terminate tax deferred plans.

This case, which involves not an act of negligence but a very purposeful breach of an ERISA-protected plan, is far more compelling than *Oddi*. The remedies allowed by ERISA are exclusive; no common law contract action may be brought for such a breach. *Pane v. RCA Corp.*, 868 F.2d 631, 635 (3d Cir. 1989). ERISA was "designed to protect the integrity of [employee benefit] plans and the expectations of their participants and beneficiaries." *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 929 (3d Cir. 1985), *rev'd in part on other grounds, Pritzker v. Merrill Lynch, Pierce, Fenner and Smith*, 7 F.3d 1110 (3d Cir. 1993); see also 29 U.S.C. § 1001(b) (stating Congressional policy). Unfunded deferred compensation plans such as the instant plan, however, were exempted from all of ERISA's protective provisions (relating to vesting, funding, and fiduciary responsibility) *except* its enforcement provisions. *Id.* at 930, 935-37. The Court of Appeals, by holding that damages are not recoverable because future tax rates are specula-

5. *Id.* at 262.

tive, has radically diminished the only protection the Congress intended such retired employees to have.[6]

In fashioning a federal common law under ERISA, our courts should not set aside principles that are as deeply imbedded in our jurisprudence as is the principle that damages which are "foreseeable and in the reasonable contemplation of the parties" are recoverable. *Hadley v. Baxendale,* 9 Exch. 341, 156 Eng. Reprint 145 (1854). The benefit of tax deferral was the very essence of the deferred compensation agreement, as it is the essence of IRA's, 401K's and all of the retirement plans protected by ERISA. The whole purpose of such plans is to allow participants to earn investment income on the money that would otherwise be paid in taxes, and to defer taxes on that investment income as well, until such time as the deferred moneys are paid to them incrementally during their retirement years. But for the benefits of tax deferral, few if any employees would give up control of their own funds and allow an employer to retain and invest a part of their salary.[7] Indeed ICI terminated the Plan after having actually calcu-

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6. Injunctive relief is not a realistic enforcement alternative. Once such a plan is terminated, albeit wrongly, participants will have constructively received the funds and therefore lost the benefits of tax deferral. The effectiveness of injunctive relief thus depends on whether a participant can obtain an injunction before the employer has already terminated the plan. Moreover, an employer's administrative review process may impede a participant's ability to obtain an injunction. In this case, petitioners formally demanded that ICI not terminate the plan, and ICI rejected that demand but instructed petitioners to seek review through an internal administrative process. Before ICI's internal review was completed, the funds were wired into petitioners' accounts. Finally, until the Court of Appeals held that damages depending on future tax rates were too speculative to be recoverable, there was no reason to believe that money damages were inadequate and therefore there was no reason to believe that injunctive relief could be granted. *See, e.g., In re Arthur Treacher's Franchisee Litig.,* 689 F.2d 1137, 1143 (3d Cir. 1982) ("we have never upheld an injuction where the claimed injury constituted a loss of money, a loss capable of recoupment in a proper action at law").

7. ICI itself urged participants to take advantage of the benefits of tax deferral in its publications relating to its various tax-deferred plans. "If at all possible, you should attempt to contribute the maximum, as the benefit of tax-free compounding over time can be significant.... Regardless of whether your contribution is tax-deductible, it pays to take full advantage of

lated how badly the retired participants would be damaged thereby. (See Appendix at 43a-46a and 47a-48a). Thus the damage from the loss of sixteen years of tax deferral was entirely foreseeable and in the reasonable contemplation of the parties and should have been allowed under *Hadley v. Baxendale's* enduring authority. *Beggs v. Dougherty Overseas, Inc.*, 287 F.2d 80, 83 (2d Cir. 1961).

II. When an employer breaches a deferred compensation plan by terminating it prematurely, the resulting damages may not be reduced by a "risk factor" to account for the possibility that the employer might not have been able to make the payments in the future.

It may be said that any defendant, no matter how solvent, may at some indeterminate date in the future become insolvent and be unable to pay its debts. It is, however, yet another radical departure from traditional American legal concepts to relieve a solvent defendant on that account from the consequences of its breach of a promise to make future payments. Here, the Court of Appeals not only held that a premium reflecting that risk may be applied to reduce damages; it held also that such a risk premium *must* be applied or damages (for this reason too) would be so speculative as to be unrecoverable.

The idea of such a risk premium was developed by one of ICI's expert witnesses at trial. He reasoned that any company that wants to issue 30-year bonds pays its lenders a risk premium — an interest rate over and above the interest paid by the United States government on 30-year treasury bonds — the amount of which depends on credit ratings made by Standard & Poor or Moody. Similarly here, he opined, it was necessary to analyze ICI's credit in order to measure the chances that it might not have been able to make some or all of the promised future payments to plaintiffs, and then to reduce

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NOTES *(Continued)*

an IRA's tax-deferred growth." Plaintiffs' Exhibit 5 (reproduced in the appendix below at 1243a-1246a).

damages by an appropriate risk premium.[8] Respectfully, the bond market analogy makes no sense. It is the *borrower* who pays the risk premium in the bond market. Here ICI is the party who "borrowed" a portion of its employees' compensation. Yet that is the concept that both the trial court and the Court of Appeals accepted, without any analysis whatsoever.

The idea that "risk premium" concepts should have any place in damage calculations is so novel that neither the trial judge in his Opinion nor the defendant in successfully urging the trial judge to accept the concept, nor the Court of Appeals was able to cite a single case or other authority in support of it.[9] This radically new concept should have no place in the

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8. See Defendant's Exhibits 11 and 42 (reproduced in the appendix below with relevant portions at 1711a and 1886a-1890a, respectively).

9. In contract claims for breach of a multi-year employment contract, or for the loss of a stream of promised future payments, damages are never reduced by a "risk discount" for the possibility that the employer might not be in business for the full contract term. See 3 D. Dobbs, *Dobbs Law of Remedies; Damages, Equity, Restitution* §12.6(1)(4), at 126 (2d Ed. 1993) ("Once an appropriate interest or 'discount' rate is determined [reducing the award to present value], the operation is a mathematical one. No further discount is required for the fact that the defendant might have been unable to perform its contract in the future or might have escaped liability at some future time because of impossibility or the like.")

Similarly in tort law, if a 40 year old man is totally disabled in an accident and sues the wrongdoer for the wages he would have earned during the 25 year period of his working life expectancy, to age 65, a jury is instructed on how to calculate 25 years of lost wages and reduce them to present value. They are *not* instructed to apply a "risk discount" in order to account *either* for the possibility that the defendant may not be able to perform, *or* for the very real statistical fact that a large percentage of 40 year old men never reach the age of 65. See *Jones & Laughlin Steel Corp. v. Pfeifer,* 462 U.S. 523, 537, 103 S. Ct. 2541, 2550 (1983), where this Court held that, to the contrary, in discounting to present value "[t]he discount rate should be based on the rate of interest that would be earned on 'the best and safest investments.' Once it is assumed that the injured worker would definitely have worked for a specific term of years, he is entitled to a *risk-free* stream of future income to replace his lost wages; therefore, *the discount rate should not reflect the market's premium for investors who are willing to accept some risk of default."* (emphasis added). See *Reilly v. U.S.,* 665 F. Supp. 976, 1018-19 (D.R.I. 1987), *aff'd in relevant part and remanded,* 863 F.2d 149 (1st Cir. 1988) (damage award not excessive by virtue of fact that heirs would receive a windfall if plaintiff did not live out her life expectancy); *Nemmers*

evolving ERISA federal common law. The Congress of the United States wanted Plan beneficiaries to have the protection of ERISA's enforcement provisions. This previously unheard of damage concept is nothing more than another way to frustrate that Congressional intent. It should not be allowed.

ICI's argument in support of a risk premium comes down to this: Despite its clear breach of contract in violation of ERISA, petitioners should not be awarded damages because they have been relieved of the possibility that some future ICI financial debacle could harm them, and the value of that "benefit" should be set-off against any damages petitioners may have incurred. That such an argument is ludicrous is apparent; that it was accepted by the Third Circuit is surprising. Certainly, such a principle should not become part of a newly emerging body of federal common law under ERISA.

CONCLUSION

For all of the foregoing reasons, Petitioners respectfully pray that an appropriate writ of *certiorari* be issued.

Respectfully submitted,

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NOTES *(Continued)*

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